CERTIFICATE OF SERVICE

I certify under penalty of perjury pursuant to 28 U.S.C. §1746 that on February 27, 2007 I caused to be served upon the parties listed on the annexed service list a true and correct copy of the accompanying Response of the Timken Company, Timken U.S. Corp., Toyotetsu America, Inc., Toyotetsu Mid America, LLC to Reply Brief of Debtors and Debtors in Possession in Support of Prior Lien Defense to Reclamation by electronic mail and by first class mail. The Office of the United States Trustee was served only by first class mail.

Dated: New York, New York
February 27, 2007

Bonnie S. Schwab

Lastly, the balancing of harms to the debtors and their estate clearly outweigh the harms alleged by Millennium. Accordingly, the motion to modify the stay and suspend payment under the note is denied.

MR. APPLEBAUM: Thank you, your Honor.

MR. ELLMAN: Thank you, your Honor.

THE COURT: It is so ordered if you want the record to suffice, or you can submit an order.

MR. APPLEBAUM: Thank you, your Honor.

MR. ELLMAN: Whatever the court prefers, your Honor.

MR. APPLEBAUM: The court's record is fine.

THE COURT: The decision is so ordered.

MR. ELLMAN: Thank you, your Honor.

Mr. Feinstein will present the last motion.

MR. FEINSTEIN: Good morning, your Honor. Robert Feinstein of Pachulski Stang Zeihl Young Jones and Weintraub. We are conflicts counsel for the debtors. With me is my colleague, Beth Levine.

MS. LEVINE: Good morning, your Honor.

MR. FEINSTEIN: Your Honor, we're here today pursuant to your Honor's October 13th, 2006 which bifurcated the reclamation issue and established the briefing schedule on the so-called valueless defense to reclamation claims arising under Dairy Mart. And your

Honor has now received extensive briefs analyzing Dairy Mart and the impact of the BAPCPA amendments as they relate to reclamation, being the amendment to 546(c) which now creates a 45 day reclamation right under the Bankruptcy Code, as well as 503(b)(9) which established administrative priority claims for suppliers.

Your Honor, I'll offer up that I have the long version and the short version. Your Honor has received papers that rival the Manhattan telephone directory. I can march through our analyses of the statute, the applicable cases, to demonstrate that because the reclaimed goods were essentially used to finance the DIP loan that was used to repay the prior lien, that all the reclamation claims in this case are appropriate valued as zero, as was noted in the debtors' notice of reclamation claims filed with the court.

And we've received 24 responses, your Honor. We they raise a core number of arguments that we've addressed in our papers and I'm happy to address for the court today.

One thing I wanted to note at the outset, your Honor, some of the papers argue that Dana tried to pull a fast one, or that there was a case for equitable estoppel because somehow reclamation claimants were taken by surprise that Dana raise the valueless defense. And in

that respect I want to point the court and those parties to the motion that was filed on the first day of this case on March 3rd establishing reclamation procedures where Dana said loud in clear in paragraph 12 that 546(c) of the Amended Bankruptcy Code provides the reclamation rights are "subject to the prior rights of a holder of a security interest of such goods or the proceeds thereof." And Dana cited to a number of the cases raising and discussing the valueless defense.

So parties were put on notice, they are generally on notice that Dairy Mart is a precedent in this jurisdiction, there are notice of the amended statute, and they were put specifically notice by Dana that this issue would be raised, and it was in fact raised as we've indicated in the pleadings leading up to the October 13th order.

As a matter of process we thought it appropriate to raise and litigate this defense first before getting into individualized issues relative to the wide variety of reclamation claims. And there are quite a number of those claims your, Honor, Dana being a large automotive supplier regularly does business with thousands of suppliers.

After the bankruptcy case was filed over 450 reclamation demands or letters were sent to Dana

invoking either 546(c) of the Bankruptcy Code, or Section 2702 of the UCC, and the total face amount of those claims was nearly 300 million dollars.

Each of the claims, the reclamation demands, asserted a right to reclaim either equipment or inventory which were the subject of a blanket lien granted to the debtors prepetition lenders.

And as the court is aware and its papers discuss in ample detail, after the case was filed Dana had obtained a DIP loan, pledged the same collateral to the DIP lender, the proceeds of that loan used to satisfy the prepetition lien. Based on Dairy Mart, it is really on all fours, those reclamation claims were rendered valueless under those circumstances.

And the reclamation claimants have now tried using cases outside this jurisdiction like Phar-Mor and the provisions of BAPCPA to argue that Dairy Mart is not good law or shouldn't be followed by this court and that their reclamation claim survives, not withstanding that their reclaimed goods were used as collateral to obtain a loan that was used to satisfy a prior lien, which clearly trumped their reclamation under well established law.

The arguments range from Dairy Mart is wrong to the amendment of BAPCPA erased years of juris

prudence relevant to reclamation to the equitable estoppel motion that I raised before. Parties have invoked the notion that they are entitled to martialling, even though it's fairly well settled that if you are an unsecured creditor, not a lienor, you have no right to invoke marshalling. And we've attempted through our reply brief that was filed about two weeks ago to address these arguments one by one.

So your Honor has before you the opening brief that we filed, 24 responses that were filed by reclamation claimants, our reply brief, and then in the last couple of days, and including yesterday a couple of sur replies were filed, although they were not contemplated by your Honor's briefing order. We can certainly -- we've read those and we've addressed those, I don't think they raise anything new or different.

So, if I could, your Honor, I'll take the arguments in sort of their larger categories. The plain language of 546(c) now, as amended, contemplates that reclamation claims are subject to the prior rights of the holders of the security interest, and in that respect 546(c) did not indicate a see change in the law, arguably it codified Dairy Mart and the other cases around the country that have held that reclamation claims are valueless where those goods are subject to a blanket lien,

which is what we have here.

And efforts to argue that somehow 546(c) changed law are really unpersuasive. And there don't appear to be any arguments in any of the opposition that can undue the clear words of the statute, which is that the reclamation claimants are subordinate to the holder of a security interest, which is what we have here.

A lot of the claimants argue incorrectly, or mischaracterize Dana's argument, that the existence of a prior lien extinguished the reclamation right. We are not arguing that. What we argued is that it subordinates the reclamation right and it makes it valueless the those goods, the reclaimed goods, are used to satisfy the prior lien. And the cases in are legion around the country where reclaimed goods are in effect liquidated and sort of disposed of to satisfy the prior lien by a variety of means. It could be done by way of a bulk sale of the goods that would be used to satisfy the prior lien, or as we had in this case and Dairy Mart, a pledge of those goods to the DIP lender where the proceed of the DIP loan are used to satisfy the prior lien which had trumped the reclamation claims to begin with.

Since the enactment of BAPCPA, there is only one case that we found that addressed this issue head on, and that was the decision of Judge Sontchi in Delaware

in the Advanced Marketing case. And while he was hearing the matter on a TRO, he did make some salient observations, which is that if the goods that are the subject of the reclamation demand are the subject of a prepetition lien or a DIP lien, that trumps the reclamation demand, it renders them valueless. And he indicated in his decision that his decision would have been the same under the pre-amendment code which incorporated state law by reference, or following the amendments under BAPCPA.

He didn't delve into the intellectual issue, your Honor, which is that now that there appears to be a Federal reclamation right separate and apart from the UCC, that I think it's up to the court now to develop Federal common law, to interpret that provision and to apply it.

Under the pre-amendment statute, 546 said that the rights under state law were preserved. So courts interpreting 546(c) pre-amendment naturally looked to the UCC and applied the traditional concepts, including the valueless defense. But now we are in a new regime, where now we have arguably a Federal reclamation right.

The claimants would argue that the establishment of a Federal reclamation right wipes the slight clean, that your Honor should disregard years of juris prudence around the country about the interaction

between reclamation claimants and secured claimants, but we don't think that that's appropriate, nor do we thing that there's anything on the statute or the legislative history that would warrant such a departure. As we've cited in our brief, a number of Supreme Court cases, including Ducna versus Tim, hold that when Congress amends a code like the Bankruptcy Code, that absent some indication by Congress of an intention to do away with preexisting precedent under the prior tradition, that there's no reason to engage in some vast departure from years of juris prudence. And here not only do you have no legislative history to that effect, you have language in the statute, the reference to subject to the prior rights of a holder of security interest that has every indication Congress intended to codify Dairy Mart.

So the arguments that we should now make law out of whole cloth and interpret this in a way that favors them simply finds no basis in the statute, it finds no basis in the legislative history.

We come back to the Dairy Mart facts. This is a case essentially on all fours with Dairy Mart. The only case the claimants can point to that reaches a different result is the Phar-Mor case by Judge Boah.

As we've indicated in our papers, Judge Boah in Phar-Mor took a very formalistic approach to an

economic transaction, which is a DIP loan that refinances a prepetition loan. What Judge Boah found in that case was that by virtue of the fact that the prepetition lender had released its security interest and the debtor granted a new security interest in the very same goods to the DIP lender, that somehow the reclamation claimant stepped up because in a nano second those goods are were released from the prepetition lien.

As we've argued in our papers, that elevates form over substance. As Judge Gonzalez found in Dairy Mart, this is an integrated transaction; the satisfaction of the prepetition lien through the use of new DIP loan proceeds, secured by the very same collateral, is in effect a transfer of the security interest, and it's a unified transaction where those goods were never free and clear, they were never not the subject of a security interest.

So under pre BAPCPA law, as well as under 546(c), the reclamation claimants were behind the holder of a security interests. And as I said, it elevates form over substance, whether the old lien is transferred, whether the goods are sold to a third party and the proceeds are used to satisfy the prepetition lien, economically it's all the same issue, and there's no reclamation claimants to hurdle over that secured lien through some novel interpretation of

the new statutory language. The basis is just not there in the language of the statute or in the legislative history. So efforts to craft new law really run against years of juris prudence and run against the language of the statute.

The other responses that claimants have put forward, aside from you know pointing to Phar-Mor and pointing to the new statute, include this notion that there should be equitable martialling. And again this is manufactured out of whole cloth. The claimants can't escape the fact that where you have individual reclamation claims for dollar amounts that are less than the prepetition secured debt, even though the secured creditor may be over collateralized, they cannot force a secured creditors to satisfy that claim out of collateral and goods other than their reclaimed goods. In effect what they are trying to do is shift the burden over to other reclamation claimants, that their goods be used to satisfy the secured lender, and that the excess collateral be treated as their goods so they can reclaim. It's simply trying to prejudice other reclamation claimants at the expense of themselves, but there's no basis in law for a reclamation claimants which is not a lien holder, to force a secured creditor to resort to one particular piece of collateral as opposed to others.

A related theme in the papers is that

somehow this is an unfairness being cast upon the reclamation claimants that benefits Dana, that this is a debtor reclamation dispute. That's just not the case. This is about equality of distribution among creditors.

When reclamation claimants try to step up and get themselves an administrative expense or some other form of beneficial treatment, they do so at the expense of other unsecured creditors.

THE COURT: Well, 503(b)(9) gives them that administrative expense.

MR. FEINSTEIN: That's exactly right, your Honor.

THE COURT: Notwithstanding the issue before me today.

MR. FEINSTEIN: That's right. And if there's any perceived unfairness in the valueless defense or the treatment of reclamation creditors generally relevant to secured lenders, Congress ameliorated that by granting under an different amendment in the Code, this right to receive an administrative expense for the goods delivered within 20 days of a bankruptcy, whether or not the creditors satisfied the reclamation requirements, whether or not they made a demand, it's simply, if you ship goods within 20 days you do not get paid.

As we've argued in our papers, that benefit

to the suppliers is something that Congress wanted to grant, but it certainly was not any evidence of legislative intent to change the valueless defense to overrule Dairy Mart, because 546(c) does contain the reference to the prior liens.

So Congress -- there's not much legislative history of BAPCPA so we can only infer that Congress saw a problem and addressed it by adjusting the equities and relevant rights, not by changing the reclamation statute but by giving the suppliers this 20 day administrative claim.

THE COURT: In all these claims has there been an analyses as to the bottom line difference between the absolute prior lien defense, and not withstanding that, the 503(b)(9) 20 day award?

MR. FEINSTEIN: I don't think so, your Honor. Basically what you are saying is have we broken down the reclamation demands between the 20 days prior to the bankruptcy and the day 21 through 45, I don't believe so.

MR. SULLIVAN: Your Honor, I believe I've cited in footnote 5 of the brief of Timken Toyotetsu. I've had previous communications with debtor's counsel, and I spelled out what was represented, to me anyway, as being the difference. It was told to me, at least as of that

point in time, that approximately 60 million dollars of the reclamation claims were entitled to administrative priority under Section 503(b)(9).

THE COURT: 503(b)(9).

MR. SULLIVAN: That's right. And as of that point in time there was only 110 dollars worth of reclamation claims remaining. So we are really only talking about a difference of I guess about 50 million dollars.

THE COURT: Okay.

MR. FEINSTEIN: Your Honor, while it's not on file with the court, I'm advised that Dana has done some investigation of this, but I don't have a breakdown for the court, your Honor.

THE COURT: Well, it's an ad hominem factoid that says that the difference is some 50 million dollars at a certain point in time; is that correct?

MR. SULLIVAN: That's what was represented to me. Whether or not that's true, I don't know.

THE COURT: That wouldn't give effect to whatever settlements have occurred in the interim.

MR. SULLIVAN: Exactly right, your Honor.

THE COURT: Okay.

MR. FEINSTEIN: Let me move on, your Honor.

Another argument that some of the

reclamation claimants make goes to the issue of good faith.

Under the predecessor provision of 546(c), reference is made to 2702 of the UCC which provided that a buyer of the goods who acted in good faith would take precedence over reclamation claimant. And as the laws have developed, and under the UCC as well, indicated that a subsequent lender like our DIP lender in this case and like the prior lien holder, would qualify as a good faith purchaser.

Interestingly, under the new provision under 546(c), the so called Federal reclamation right, there's no longer a reference to good faith. And as we've indicated in our brief, it's most likely, although we are speculating, and we ask this of legislative history, but it's most likely because routinely lenders are treated as good faith purchasers.

But it's something of a red herring now for, particularly in light of the new statutory language, for reclamation claimants to argue that the DIP lender didn't act in good faith, that there needs to be discovery on this issue or that it's even a legal issue at all. It's really not relevant now under the new statutory provision.

Another argument that is made incredibly in some of the opposition papers is that somehow that your Honor's DIP loan approval order affected their reclamation

rights or -- some of them argued that it actually established the primacy of reclamation claimant's rights over the DIP lender's rights, which is simply absurd.

And the claimants point to paragraph 30 of the DIP order, the final DIP order is entitled setoff rights of third parties. But those claimants who made this argument only selectively quoted it, they left out some fairly important words. Nowhere in this paragraph is there any reference to reclamation. The paragraph that they are pointing to indicates that nothing in the DIP loan order will effect if the validity, enforceability or priority of any setoff recoupment or other claim right or defense of any customer or supplier of any debtor in respect of any account receivable, payment intangible or other payment obligation of that customer.

Now the reclamation claimants who have pointed to this paragraph have left out the language "or any other payment obligation" and have tried to engraft their own interpretation onto this paragraph to say that this paragraph was not intended to effect their reclamation right, that their reclamation rights survived the DIP order, take primacy over the super priority lien of the DIP lender, and they get there, as I said, by managing the provision and really misquoting it.

But this paragraph 30 of the DIP order does

not address reclamation rights, and certainly does not, as they continued, give their reclamation demand priority over a DIP lender who was granted a super priority lien and super priority administrative expense by your Honor by Section 363 of the Bankruptcy Code. So that argument as well is unavailing.

Your Honor, I think I have catalogued and addressed the principal arguments by the claimant's. I refer your Honor again to our lengthy briefs on the issues, and will certainly answer any questions that your Honor has about the issues.

Thank you.

MR. SULLIVAN: Your Honor, James Sullivan of McDermott Will and Emery on behalf of the Timken and Toyotetsu reclamation creditors.

Your Honor, as the debtors' have would have it, and I'll just kind of outline what I perceive to be at the trust of the debtors' arguments. First, they want you to ignore what actually happened in favor of what they wish happened.

Second, they want you to recognize a deemed or effective disposition of the reclaimed goods as opposed to an actual one; they want you to -- they basically want you to permit them, as opposed to the prepetition lender, to decide after the fact how their assets should have been

martialled as part of the deemed disposition to satisfy the prepetition debt in a way that wipes out all reclamation claims.

So contrary to what the debtors are saying, we are not the ones seeking to marshal the assets. The disposition has already occurred --

THE COURT: They are not wiping out all reclamation claims, they remain liable under 503(b)(9) for the 20 day reclamation claims not withstanding any argument here.

MR. SULLIVAN: Well that's a separate issue, your Honor. When I'm talking about the reclamation claims I'm not talking about the 503(b)(9) which no one disputes survives. What I'm talking about is the I guess really we are talking about the reclamation demand with respect to goods that were shipped between 20 and 45 days prior to the bankruptcy filing.

But what the debtors are arguing is that somehow the reclamation creditors are trying to seek some kind of martialling. That's not what's happening here. What's happening here is the debtors are seeking to stand in the shoes of the secured creditor and make an argument after the fact as to what they wish had happened.

What happened is that the prepetition lenders were not repaid from proceeds of the refund goods,

but from the proceeds of the DIP loan. What they want you to say is look even though we didn't pay off the prepetition debt with the inventory that is the subject of the reclamation claims; we wish it had and we want you to find that it effectively did, even though it didn't actually. So that's what's really happening. It's not like the reclamation creditors are coming into court and asking you to marshal.

Normally when you are talking about martialling you are talking about a dispute between two creditors. There's no other creditor at the other side of the table, your Honor; I'm not arguing with another creditor. I'm arguing with the debtor. And you shouldn't give the debtor standing to, in essence, step into the shoes of the prepetition secured creditor, who is not here asking you to do anything, your Honor.

All we are doing is we're coming in here and saying look the debtors' argument that somehow you should ignore the facts, ignore what actually happened, and allow them to avoid having to make good on the reclamation goods, it's just an absurd position, and there's no basis for it. They have no standing to even assert this martialling argument, and it would just be inequitable.

Just to point out a few reasons why their argument is absurd.

THE COURT: Getting back again to my prior inquiry. Essentially the goods at issue are those that were shipped more than 20 days, between 20 and 45 days out.

MR. SULLIVAN: That's correct, your Honor.

THE COURT: It's issue does not relate at all to the goods shipped in the 20 day period prior to insolvency.

MR. SULLIVAN: I don't see it, because all the reclamation creditors are going to get their 503(b)(9) claim. Maybe there's a few out there.

THE COURT: I'm just making a practical inquiry to see exactly what's at stake here.

MR. SULLIVAN: Yes. Certainly my clients are not requesting reclamation of its goods, they are happy with the 503(b)(9) claim. So to the extent that there's a dispute as to that, it certainly doesn't lie with us, and I doubt it would lie with any of the other reclamation creditors.

THE COURT: You mean you get your claim complete because you have no goods that were received more than 20 days prior to the filing?

MR. SULLIVAN: Your Honor, I'm only arguing about the goods that were shipped more than 20 days; that's all I'm arguing about today.

THE COURT: Does your client fit that

category?

MR. SULLIVAN: Yes, your Honor.

THE COURT: Okay, that's what I'm asking.

MR. SULLIVAN: So --

THE COURT: I'm asking that only because you are raising standing issues, and I wonder if everybody here, or a good portion, are covered by the 20 day 503(b)(9), I doubt you have standing.

MR. SULLIVAN: I would agree with that, your Honor. And I'm sure if they were covered by it, I doubt that they would bother to object. So maybe that's why some of the reclamation claims have dropped by the wayside; I don't know.

But just to kind of point out some of these reasons. First of all, it's undisputed, and the debtors acknowledge this, that the reclaimed goods, the goods falling between 20 and 45 days, neither those goods or nor the proceeds of those goods were actually used to repay the prepetition debt. Undisputed, your Honor. I think that in and of itself that admission should do away with this whole hearing.

Secondly, the prepetition liens were not assigned to the DIP lender as part of the deemed disposition, therefore, if you look at the -- and there's a dichotomy in the Phar-Mor case versus the

Pittsburgh-Canfield case where that really made the difference, because the Pittsburgh-Canfield was decided one way, the Phar-Mor case was decided the exact opposite way, predominantly, if not solely, as a result of the fact that the -- there was no stepping into the shoes of the prepetition lien holders lien. So the DIP lender didn't take over the liens of the prepetition lien holder, and the Phar-Mor court found that fact to be dispositive.

And it also cuts against the debtors' argument here, because not only was there no assignment of the prepetition lien, which was in essence released as part of the transaction, but there really was no integrated transaction as it occurred in the Dairy Mart case.

This case is distinguished from Dairy Mart. Unlike what the debtors are trying to tell you, it doesn't lie on all four with the Phar-Mor case, and there's a few notable distinctions.

THE COURT: You mean with the Dairy Mart case.

MR. SULLIVAN: I'm sorry, the Dairy Mart case; that's correct, your Honor.

First of all the collateral package was not identical. The Dairy Mart case made a lot of the fact that the collateral package between by both the prepetition lender and the postpetition lender was identical. And in

both situations both lenders had liens on basically, if not all, substantially all of the debtors' assets, but it was in essence an exact match in terms of what the collateral package is. That's not the case here, your Honor. There's a number of differences between the collateral package between the prepetition lender and the postpetition lender.

In addition, in the Dairy Mart case the DIP lien was made subject to the liens of the prepetition lien holder, and therefore it wouldn't make sense for the DIP lender to agree to lend on that basis unless the prepetition lender was definitely going to get repaid as part of the DIP loan.

In this case, your Honor, the prepetition liens were made subject to the DIP liens. So as far as the DIP lender is concerned they could care less whether or not the prepetition liens get repaid and so therefore they are not going to condition a repayment of their prepetition lien as a condition of making the loan, because their liens prime the prepetition lenders. So, again, this isn't the type of integrated transaction that you had in Dairy Mart. So on those two grounds you have a very, very different fact pattern.

Also, I think even if for some reason the court were to find the Dairy Mart case as having some kind of validity, and I would mention to the court that

notwithstanding what the debtors are telling you, it's not like there's a long history of cases that agree with the Dairy Mart decision in which Congress somehow, you know, by not specifically mentioning some kind of overruling of Dairy Mart impliedly are telling you that you should follow Dairy Mart. In fact the opposite is true, your Honor.

I would represent that Dairy Mart is basically a case that's kind of alone in the woods somewhat. All the other cases that are cited in the various briefs, even by the debtors, really don't reach a conclusion anywhere near what the Dairy Mart case. And all of those cases basically acknowledge the truth, which the debtors cited in the reclamation procedures motion when they filed it.

What they said was, look, it's a wait and see kind of approach that you have to take when you are dealing with reclamation claims. If the reclaimed goods are sold to satisfy the prepetition debt, sorry reclaim creditors, your claim has no value. But if the reclaimed good is not sold to pay down the prepetition debt, all of a sudden it has value.

And they cited in their reclamation brief the following quotations from Arlco and Pester, in which they said, after the secured creditors superior rights have been satisfied or released, which is exactly what happened

here, your Honor, the reclaiming seller retains a property interest in any remaining goods and in any surplus proceeds from the secured creditor's foreclosure sale.

So contrary to what the debtors are telling you, they didn't put anyone on notice that this is what they were intending to do. For example, and part of the what the argument is that this is just like what happened in Pittsburgh-Canfield. The language in the reclamation procedures motion here is nothing like the language in the Pittsburgh-Canfield case.

In the Pittsburgh-Canfield case they specifically said that the debtor would be asserting that the bank lenders' liens trumps the reclamation creditors. That's not what happened here, your Honor. Basically when you take a look at the language in the reclamation order which basically suggested to creditors, look, if it happens that we don't repay the prepetition debt with the proceeds of the reclaimed goods, you are going to have value here. And that's what the cases that they quote in their reclamation procedures motion say.

When you couple that with a DIP motion which says that we are going to do is we are going to pay down the prepetition debt with the proceeds of the DIP loan, you have a bunch of reclamation creditors out in the audience saying whoopee, our reclamation claims are going

to have to some value here. We're not going to object to any of this stuff because at the end of the day the reclamation claims are going to have value.

So for the debtors to sit here and to suggest that their papers put reclamation creditors on notice that they were going to seek to wipe out all of their reclamation claims on the basis of this prior lien defense and the Dairy Mart case is absurd. They didn't even cite the Dairy Mart case in their papers. They never indicated that they were going to bring such a motion, and the statements in their motions gave the reclamation creditors the exact opposite impression, that they were going to pay down the prepetition debt with the proceeds of the DIP loan, not use the proceeds of any reclaimed goods, and that if that happened that the reclaimed goods would have value.

So I find, or at least in my argument is that the debtors should be equitable estopped from raising the prior lien defense at this time because their actions caused the reclamation creditors to sit by and, you know, to sit on their rights when absent such conduct on their part the results may have been very different.

And, your Honor, I'm not sure if I quoted in my papers, but the facts of this case in that regard are somewhat similar to what happened in the Flemming case,

where the Flemming debtors pulled the same kind of stuff, and Judge Wohlrath basically laid into the debtor's counsel for doing that same kind of stuff. She issued an opinion that basically chastised the debtor's counsel for doing this exact same thing and ended up making deductions in terms of their attorneys fees as a result of it.

So, you know, for them to suggest that they put reclamation creditors on notice, your Honor, I just don't think that that's the case.

Your Honor, aside and apart from the reasons that I set out, I think that if the court were to acknowledge the prior lien defense as set forth by the debtors, it would really create a grossly inequitable result and would provide perverse incentives for both debtors and creditors in future cases.

In terms of future incentives, what it would do is it would incentivise debtors from liening up some of their inventory prior to a bankruptcy filing, shortly before a bankruptcy filing; not to suggest that debtors would necessarily do it, but it certainly highlights the problem here.

And I pointed it out in a hypothetical on page 17 of my initial brief that hypothetically speaking a debtor could, let's say a hundred days prior to the bankruptcy filing, kind of like what happened here, a

A0899

hundred days prior to the bankruptcy filing the debtors liened up their assets. And, you know, just pick a number out of a hat, they could get a lien of a million bucks, not a lot considering maybe you have hundreds of millions of dollars of inventory, maybe billions of dollars worth of assets as the debtors have here, and let's say there's reclamation claims, potential reclamation claims of a few hundred million bucks. By refinancing that as part of a DIP loan --

THE COURT: In your scenario there would never even be a bankruptcy. This is a good solid debtor.

MR. SULLIVAN: Well, the facts aren't all that different here, your Honor. And in fact we do have a bankruptcy. You have a debtor a hundred days prior to the bankruptcy filing, they have no secured debt. They lien it up with about 400 million dollars worth of debt.

THE COURT: You don't profile Dana with your example.

MR. SULLIVAN: Excuse me, your Honor?

THE COURT: You don't profile Dana with your example.

MR. SULLIVAN: Not exactly. But I was just trying to show the absurdity of their petition by taking it a little bit to an extreme. But I can use this as the example of the Dana case, and I think it's almost equally

A0900

as absurd, where you have over 2 billion dollars worth of collateral in connection with a 400 million dollar loan and you have, by choosing to use solely the reclaimed inventory, or just about, to pay down that debt through a refinancing, it's grossly inequitable when you have approximately 1.8 billion dollars worth of other goods that are available to repay the debt.

Why choose or why allocate it or marshal it, like the debtors are asking you to do, in a way that defeats the rights of reclamation creditors as opposed to, you know, some other way, you know, either choosing to do it from the non --

THE COURT: Because lenders are greedy. They want to get liens on everything in sight.

MR. SULLIVAN: And we have no problem with the lenders. They are not on the other side of the table, your Honor.

THE COURT: You have no problem with greedy lenders?

MR. SULLIVAN: Well, we do, but in this case we have no dispute with them because they are not on the other side of the table, your Honor. It's the debtor that's trying to stand in the shoes of the secured creditors.

The secured creditor here is indifference,

they've already been repaid. They are happy to get repaid from the proceeds of a DIP loan or from goods that aren't reclaimed goods or other assets as opposed to reclaimed goods. They don't care.

But for some reason, the debtors took it upon themselves to try to ask you to go back in time and to kind of change things around in a way that they wish it happened. They wish they had gotten assignment of their liens. They wish they had paid off maybe the reclaimed goods with the proceeds of -- I'm sorry, repay the prepetition debt with the proceeds of reclaimed goods, but they didn't, and they acknowledge all of this. So for them to try to rewrite history, your Honor, and use that rewritten history to wipe out all the reclamation claims is just absurd, your Honor.

I'm going to respond to a couple of points that were raised by the debtor that I didn't get to so far. The debtors posit that what the Phar-Mor case does is posit form over substance. Your Honor, what I suggest is that what the debtors are doing is they are positing fantasies over reality. They are asking you to pretend that the facts of this case are other than what they are.

The facts of this case are the proceeds of the reclaimed goods were not used to pay down the prepetition debt. They want you to pretend that it was.

It just doesn't make any sense to do that.

As far as the good faith issue, your Honor, and, you know, to some extent you don't need to address this if you end of up ruling in your favor. But in terms of good faith, they suggested that the case law is universal or uniform in the holding that all secured creditors are good faith lenders. There's just no case law that says that, your Honor. In fact, the abundance of case law which we cited in our brief suggests the opposite. Maybe in some cases, such as the Dairy Mart case, good faith was not in dispute. But there's no basis for the debtors to suggest that all good faith -- I'm sorry, all lenders are good faith lenders. And I don't think your Honor would agree with that either.

In terms of paragraph 30 of the DIP order, your Honor. I can at least represent -- I don't know what other creditors did, but I can at least represent to you that we did refer to the entire language of paragraph 30. And I don't believe that paragraph 30 does what the debtors say it does. If it does then, it was certainly poorly drafted. And to the extent there's any ambiguity in the paragraph 30, it should not be held against the reclamation creditors, but the debtors and/or the DIP lenders.

But in any case I don't think you really need to reach the issue about what paragraph 30 says or

what it doesn't say, because I don't believe it's dispositive in terms of deciding this motion.

The debtors never asked you to value the reclamation claims as zero based upon the existence of the did DIP loans, so you really don't need to address it in that sense. You know, if they had made that argument, reclamation creditors or if paragraph 30 truly did trump the reclamation claims, the reclamation claim holders would have probably sought adequate protection. And to the extent the court finds paragraph 30 makes the DIP liens come ahead of the reclamation claims, then we would respectfully request adequate protection of our reclamation rights.

And the final policy argument, your Honor, in terms of perverse incentives is that basically if the court decides to rule in favor of the debtors on this issue, what it's going to do is it's going to create perverse incentives for reclamation claim holders in the beginning of the case to seek formation of a committee to object to a good number of the significant first day motions in the case such as DIP motions, cash collateral motions, reclamation procedures motions, as well as any potential sale motions involving, you know, I guess whether it be sales involving reclaimed goods or not; any kind of motion that's going to --

THE COURT: That's a policy issue that deals with proliferation of committees. Both the U.S. Trustee and the court are gate keepers in that regard, so that kind of horrible is not necessarily one that this court recognizes as really legitimate.

MR. SULLIVAN: Well, whether it be official or committees or unofficial --

THE COURT: In fact, you are even making the suggestion that those kinds of committees probably are illegitimate and shouldn't be formulated and given a voice in the Tower of Babble.

I think the courts are pretty well able to distinguish the makeup of a Tower of Babble. And notwithstanding the entry with the academy awards of a picture of that name, too many of the cases before this court are Towers of Babble, and I don't see that that's a real danger that we have to worry about.

MR. SULLIVAN: Well, all I'm suggesting, your Honor, is there's --

THE COURT: There is always a motive for people to get together to have a voice, and motivation in that regard comes from a whole host of areas.

MR. SULLIVAN: But what I'm suggesting, even more so than the committee part of it, that it's going to proliferate a bunch of litigation in the beginning of

the case when really what you want is creditors to try to work in tandem with the debtors and try to move towards a consensual case. And what this is going to cause is a bunch of litigation in the beginning of a case to deal with a lot of these kinds of issue. And I just think it's probably not in the best interest of the debtors in an overwhelming majority of cases to require creditors to do that.

THE COURT: I think, on the other hand, the debtor probably wants to make the same argument to get a legal principal in place that will end the uncertainty and you won't have a lot of litigation whether either side prevails. I think that's a fair statement.

MR. SULLIVAN: Let me take it to a little bit of a -- to give you an example to kind of highlight my point.

In cases such as this, what you have is a debtor. They are thinking, how do I create value in a case?

THE COURT: If the lien theory holds, and it is a total block, then there's no need for litigation. It won't happen. That if this is either a Phar-Mor or a Dairy Mart jurisdiction, everybody will know. Isn't that what's at stake here right now?

MR. SULLIVAN: I suppose if you were to

decide that, well, it's certainly not -- until the Second Circuit of the Supreme Court rules on this issue, my guess is it's not going to end the litigation. But what you end up having is you are creating an incentive for the debtors to refinance debt to wipe out all reclamation claims as opposed to just liquidating the collateral in which case maybe some reclamation lose value, but maybe some survive.

But it creates a perverse incentive that somehow you can, by refinancing to 2 billion dollars worth of collateral, you wipe out all reclamation claims. It just doesn't make any sense. It's grossly inequitable.

THE COURT: Over the years I've heard this form of argument many times, especially in retail chain cases, where right after Christmas there is a filing after they're bulked up with consumer sales and they are now loaded and they have tremendous obligations they file. Is that fair? There's a whole part of the community that thinks it's not fair.

MR. SULLIVAN: It's probably what lead to a revision of the Bankruptcy Code recently, your Honor.

THE COURT: I'm not sure that that's what lead to a revision.

MR. SULLIVAN: Maybe not solely, but --

THE COURT: What really lead to a revision was a consumer oriented issue, which is really not a

Chapter 11 or reorganization issue at all.

MR. SULLIVAN: But the reclamation issue really has nothing to do with consumer cases. I mean the reclamation -- I would posit that it's hard to tell exactly what Congress did because they didn't really tell us, but --

THE COURT: I agree. I think we all agree.

MR. SULLIVAN: So... all right, I think that covers most of the major points that I wanted to cover, your Honor.

THE COURT: Thank you.

MS. COPLEY: Good morning, your Honor. Dawn Copley for Akebono Corporation and FANUC Robotics Systems.

Your Honor, I'm going to be rely brief, I just want to make a few points. Debtor's counsel kept reiterating that Dairy Mart is on all fours with this case. Well, Phar-Mor is as much on all fours of this case as Dairy Mart if not more so, particularly because there are a couple of issues, and I think counsel also raised, my fellow reclamation claimant, that it in this case it's exactly as it was in Phar-Mor where the prepetition lender has released its liens, and then the postpetition lender, the DIP lender, was granted new liens. It's exactly the way that it was in Phar-Mor, and the court in Phar-Mor

actually acknowledged that.

Dairy Mart does not speak to whether or not the prepetition secured lender was over secured but Phar-Mor does, and it says that the prepetition secured lender was over secured as this prepetition secured lender was over secured in this case. So there are some similarities between Phar-Mor and this case that don't exist between this case and Dairy Mart.

And when Congress also, we just acknowledged we don't know what Congress was thinking because there is no legislative history for the revisions to the reclamation statute.

THE COURT: That posits a theory that we don't know what we are thinking when we elect people into Congress.

MS. COPLEY: But there's no more indication that Congress was codifying Dairy Mart any more than it was codifying Phar-Mor, all the statute says is that the reclamation claims are subject to the prior lien of its prepetition secured creditor. I don't think any of the -- at least from my reading of the briefing, that any of the reclamation claimants have said that it's not subject to. We've not said that, so we don't know what Congress was thinking as far as whether it was codifying anything. Perhaps it was codifying all of the case law that at least

acknowledge that prior lien, but not going to the extent of saying but they are all valued at zero, as the debtor would suggest that is what Congress intended. I think if Congress intended loan would be valued at zero, it would have said that in the statute. It would have said they are all valued at zero.

THE COURT: Yes, but it might have had another thought in mind whether it gave an award under 503(b)(9).

MS. COPLEY: Well, that could very well be as well, your Honor, and I guess that's for the court to decide, which reasoning is more bound to this court. But there are cases that aren't just the Phar-Mor and the Dairy Mart case. While those are the ones that I think the parties here have probably raised most often, there is also Pester Refinancing where the court held, and in that case the prepetition lender was also the postpetition lender, and it was paid through the plan of reorganization not using the collateral that represented the reclaimed goods, and the court in that case said when a prepetition lender is paid from any other source, any other source than the proceeds of the reclaimed goods, then the reclaimed goods have value. The reclaimant's claims have value.

So I think that we can't ignore that case as well because there is, in this case, payment from

another source.

As I said, your Honor, I represent two claimants, Akebono and FANUC, and I just want to raise one issue for FANUC. FANUC did not provide inventory to debtor, FANUC produced robotic systems, it's equipment the debtor uses, and the debtor is using that equipment now. That is equipment has not been disposed of to pay the prepetition lenders, not even withstanding that the debtors have already acknowledged that none of the reclaimant's goods were used to pay the prepetition lenders. Certainly this equipment is not being used to pay either prepetion lenders or the postpetition lenders, it's being used by the debtor to manufacture its goods.

So I think FANUC in particular, their claim should survive any claim of the prepetition lender.

Thank you, your Honor.

MR. GELDERT: Your Honor, Brian Geldert of Akin Gump Strauss Hauer and Feld on behalf of Hain Capital Group.

I think there's been a lot of focus on 503(b)(9) here, and what we lose are the claims that are asserted arising from the 21st day to the 45th day. And what I think all the parties agree on is that Congress did enhance the right of reclamation claimants when they amended the Bankruptcy Code. They provided them

administrative claims for the goods delivered within the first 20 days, but they also extended the reclamation period for reclamation claimants.

What we have here is reclamation claims that are subject to the rights of the prepetition secured lien holder. This lien holder is over secured and it was paid off from the proceeds of the DIP. So taking Dairy Mart and applying it to a case like this, in our view, effectively in every case where there's a debtor in possession financing, would wipe it reclamation claims asserted based on the 21st day to the 45th day, and that cannot be what Congress intended to be the result by enlarging the reclamation creditor's rights. And I think that was, I just wanted to add that.

MR. RENDA: Your Honor, Thomas Renda on behalf of Emhart Technologies and Hydro Aluminum. We had filed a pro hac motion last week. Your Honor, Emhart and Hydro both supplied credit on the basis of 60 day terms right until the very eve of the bankruptcy, and so I think that my clients in fact do have standing to raise the issue concerning the gap between those 20 day provisions of Section 503(b) and the enhanced reclamation rights that go to 45 days.

I'm not going to repeat points that have been previously made, your Honor, I'm just going to point

our a couple of things that haven't been mentioned so far, at least expressly.

There's been a statement that the Phar-Mor case is a mechanistic approach. I think frankly Phar-Mor and Dairy Mart are somewhat mechanistic at how they arrived at their result, but before the 2005 amendments have said that there was no real reason to suggest that one was more valid than the other or less persuasive than the other.

I do think that the language in Section 546(c) now, which refers to prior rights of secured lenders, is a little bit more restrictive than what the debtor would have you find here, because they are really not holding up prior rights of secured lenders in this case, they are really holding up new rights of the postpetition lenders as a way of defeating rights to reclamation claims.

THE COURT: Doesn't Dairy Mart say this is one integrated transaction?

MR. RENDA: Dairy Mart does say that, your Honor. And again, were it not for the fact that the statute changed, and were it not for the fact that the Congress has directed us to look for to prior rights of secured lenders, I would say the court would be probably advised to follow Dairy Mart, but I think you could read Section 546(c) to restrict that, and say that, as we

understand, a prepetition lender has rights that are superior to but do not eliminate or trump, I think was the word that the debtors' counsel used, do not eliminate or trump the reclamation claims, they simply come first.

And now it's being argued, after Congress enacted Section 546(c) and it said pay attention to the prior lender's rights, but now a new lender can essentially have greater rights. And I think that's a result that would be a little surprising to Congress when they enacted this legislation.

Your Honor, with respect to the issue of the DIP order in section paragraph 30 of the DIP order, the debtor has pointed out that the language in that section of the order makes a reference to payment claims. I note, your Honor, that they had to highlight that, in explaining what the section meant had to highlight it. And it seems to me that it is ambiguous, that that language, especially coupled with a reclamation motion which referred to reclamation rights, as we commonly understand it, which is that the secured lender's are superior, but that the reclamation rights come behind the secured lender, that those two, in concert, do give the court grounds to hold that there should be some sort of estoppel from now asserting that the DIP order somehow had even great rights than the prepetition lenders.

Certainly that wasn't noticed out to creditors and reclamation claimants, they weren't served with notice; they weren't serve with a notice that their reclamation claims would be eliminated by the entry of a DIP order. We don't know whether the DIP lender would have agreed to allow the reclamation claims to be paid because we haven't been given the chance to seek that discovery. My suspension is that the DIP lender may not have been sanguine about the prospect of lending against inventory that was subject to reclamation claims, especially in light of the changes that took place in the statute in 2005. We would like to find that out.

And lastly, your Honor, the question of martialling, it seems to be a little bit of a red herring. Even when your Honor has two liens, two consensually granted Article 9 liens, the bankruptcy courts don't generally marshal, it's really a question of adequate protection. The junior lender rights are adequately protected if the senior lender sells collateral that the junior lender has a lien in, and typically there would be an adequate protection stipulation that is entered into.

In this case what you are being asked to do is to presume that when a fairly large amount of collateral that is more than sufficient to pay the reclamation claims is pledged to a new lender, that the presumption ought to

be that all of the collateral necessary to pay the reclamation claims is being used up to the exclusion of other collateral. I just don't think, especially after the enactment to the changes to the Code in 2005, if that's a presumption that the court out to indulge.

That's all I have, your Honor.

THE COURT: Thank you.

MR. LEONARD: Robert Leonard of Torre, Lentz, Gamell, Gary and Rittmaster on behalf of Berlin Metals LLC. I have to give you a card.

We submitted a brief, your Honor, and I'm going to address that. I wanted to address first the pages 23 to 25 of the reply brief of the debtors. They make it clear that a cornerstone of their position is the assertion that, and I quote, "reclamation claims are not secured claims." And I quote again "suppliers asserting reclamation rights are not secured creditors." I'm not sure why they say that. They don't really cite much authority for that. They certainly don't cite any authority based on the statute to that effect. And my initial reaction is why are not they not secured creditors?

THE COURT: Did Congress say or use the word lien in the statute?

MR. LEONARD: No, they did not.

THE COURT: So you want to elevate them,

the debtor wants to demote them. But if you want to elevate, I think you need something black and white to do that.

MR. LEONARD: Well, they merely refer to a right. They certainly refer to --

THE COURT: But that doesn't make them a secured creditor.

MR. LEONARD: It may not. It may and it may not, I would certainly agree with that. But it does give them a --

THE COURT: Well, ought Congress tell us if it wants to make them a secured creditor?

MR. LEONARD: I think it would have been nice if they had done so, yes.

THE COURT: Well, it would have been nice if Congress had done a lot of things and given a little more forethought. It may well be that two different partisans got into separate closets and did some drafting and handed both drafts to a drafts person and said, here, put this together and this is our statute.

MR. LEONARD: But each the debtors' briefs, and both of them admit, that the reclamation right is an in rem right, it is an in rem right in the property which was sold to the debtors. That some kind of an interest, some kind of a property interest. A property interest is